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MAR 14 2008

U.S. BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA**

In re:) Chapter 7
JOSE CORELLA and ROSA DELIA)
CORELLA aka Rosa Delia Navarro,) Case No. 4-06-00864-EWH
Debtors.) **MEMORANDUM DECISION**

I. INTRODUCTION

In this case, the Trustee, at the court's direction, filed an Order to Show Cause seeking revocation of the Debtors' discharge. The court's direction was procedurally incorrect, but even if the Trustee had followed the proper procedures, the Debtors' discharge cannot be revoked because the Trustee was aware of Debtors' failure to file their tax returns prior to the entry of their discharge. Accordingly, the Trustee's request for revocation of discharge is denied.

II. FACTUAL & PROCEDURAL HISTORY

When the Debtors filed their pro se Chapter 7 case on July 27, 2006, they had not filed their 2006 tax returns ("Returns"). The Chapter 7 Trustee informed them that a portion of their 2006 state and federal tax refunds (if any) were property of their bankruptcy estate and instructed them to file their Returns. The Trustee also obtained

1 from the Debtors a signed "acknowledgment," which the Trustee filed with the IRS
2 directing the turnover of any 2006 tax refund to the Trustee. However, because the
3 Debtors did not file their tax return, the acknowledgment has had no effect.¹
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5 The Trustee sent letters to the Debtors in January, prior to the entry of their
6 discharge on April 11, 2007, and again in May and October of 2007, reminding them of
7 their obligation to file their Returns, but the Debtors failed to do so. On November 27,
8 2007, the Trustee filed a Motion for Turnover demanding that the Debtors turn over
9 copies of their Returns and any associated refunds. The Debtors failed to appear at
10 the January 8, 2008 hearing on the turnover motion. At that hearing, the Trustee
11 informed the court that the entry of a judgment for any 2006 tax refund was not feasible
12 because the Debtors' failure to file their Returns made it impossible to determine the
13 amount of a judgment. The court instructed the Trustee to file an Order to Show Cause
14 why the Debtors' discharge should not be revoked for failure to comply with a debtor's
15 duties under the Code.
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18 On February 7, 2008, the Trustee filed an Application for Order to Show Cause
19 why the Debtors' discharge should not be revoked. The Trustee served the Debtors
20 with the Oder to Show Cause by first-class mail on February 12, 2008. The Show
21 Cause hearing was held on March 8, 2008. The Debtors did not appear or otherwise
22 respond. There is no evidence that the Debtors have filed the Returns.
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26 ¹ The acknowledgment procedure was worked out by the U.S. Trustee and the IRS.
27 Apparently, the "acknowledgments" can expire and/or are sometimes ignored by the IRS
28 which may result in Debtors receiving a tax refund which properly belongs to the estate.

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III. JURISDICTION

The court has jurisdiction over this matter under 28 U.S.C. §§ 1334(b) and 157(b)(A), (E) and (J).

IV. ISSUES

1. Can an Order to Show Cause Procedure be used to revoke a discharge?
2. Should the Debtors' discharge be revoked?

V. DISCUSSION

Under the amendments made to the Bankruptcy Code by BAPCPA, a debtor must, at the request of a trustee, file with the court any federal tax returns "with respect to each tax year of the debtor ending while the case is pending." U.S.C. § 521(f)(1). The Returns fall squarely within the provision of § 521(f)(1). Furthermore, debtors must "cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties." 11 U.S.C. § 521(a)(3). Assuming that the Debtors were entitled to receive a refund, the failure of the Debtors to file their Returns may have prevented the Trustee from performing her duty to collect assets of the estate for distribution to creditors.

A. Order to Show Cause Procedure May Not be Used to Revoke a Discharge

The Trustee, following the court's direction, filed an Application and Order to Show Cause why the Debtors' discharge should not be revoked. The court's direction was wrong.

Federal Rule of Bankruptcy Procedure 7001(4) requires such actions to be filed as adversary proceedings. In re Stedham, 327 B.R. 889, 900 (Bankr. W.D. Tenn.

1 2005). An order to show cause is a motion. Motions are contested matters under
2 Federal Rule of Bankruptcy Procedure 9014 -- not adversary proceedings.

3 B. Even If The Trustee Filed an Adversary Proceeding, She Would Not
4 Prevail Under § 727(d)

5 It is less than one year since the Debtors received their discharge and the case
6 is not yet closed. The Trustee, therefore, still has time to file an adversary proceeding
7 seeking revocation. See 11 U.S.C. § 727(e). The court will, therefore, briefly review
8 the Trustee's § 727(d) claims.
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10 The Trustee, as the party seeking revocation, bears the burden of proof by a
11 preponderance of the evidence. Because revocation is an extraordinary remedy,
12 § 727(d) is liberally construed in favor of the debtor and strictly construed against the
13 party seeking revocation. Stedham, 327 B.R. at 900.
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15 Section 727(d) permits revocation in the following circumstances:

- 16 (1) the discharge was obtained through fraud and the requesting party
17 did not know of such fraud until after the granting of the discharge;
18 (2) the Debtors acquired property or became entitled to acquire
19 property that would be property of the estate and knowingly and
20 fraudulently failed to report the acquisition of or entitlement to such
21 property or to deliver or surrender such property;
22 (3) the Debtors refused to obey a lawful order of the court;
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1 (4) the Debtors failed to satisfactorily explain a material misstatement
2 in an audit conducted under § 586(f) of Title 28 or failed to make
3 documents available for such an audit.
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5 11 U.S.C. § 727(d).

6 There is no evidence that the Debtors were subject to an audit in this case.
7 There is also no evidence that the Debtors failed to follow a lawful order of the court.
8 They did fail to file their Returns as demanded by the Trustee, but the Trustee never
9 obtained a court order requiring them to do so, so § 727(d)(3) does not apply.
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11 In order to prevail under either 11 U.S.C. §§ 721(d)(1) or (d)(2), the Trustee
12 would have to demonstrate that she did not learn of the Debtors' refusal to file their
13 Returns until after the discharge was granted. See In re Eppers, 311 B.R. 826, 831
14 (Bankr. D. N.M. 2004) (the party seeking revocation under § 727(d)(1) must prove that:
15 (1) the debtor procured his discharge by fraud; and (2) movant was unaware of the
16 debtor's fraud prior to the discharge); see also In re Dietz, 914 F.2d 161 (9th Cir. 1990).
17 In In re Osborne, 2008 WL 56021 (Bankr. W.D. Ky. Jan. 3, 2008), the court held that
18 even if a debtor's conduct meets the requirements for discharge revocation under
19 § 727(d)(2), because the creditor knew of the conduct before the debtor received the
20 discharge, the creditor was estopped from seeking revocation.² In this case, the
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24 ² Arguably the failure to file a tax return falls within the provisions of § 727(d)(2).
25 Section 727(d)(2) refers to property or the right to acquire property which would be property
26 of the estate. Filing a tax return may generate a right to a refund which would be property
27 of the estate. Numerous courts have revoked discharge because of a debtor's failure to
28 turn over a tax refund. See In re Klages, 381 B.R. 550 (8th Cir. BAP 2008); In re Echart,
374 B.R. 596 (Bankr. E.D. Tex. 2007); In re Muniz, 320 B.R. 697 (Bankr. D. Colo. 2005) (All
cases where the Trustee filed an adversary proceeding).

1 Trustee knew, before the Debtors received their discharge, that they had failed to file
2 their Returns. She cannot, therefore, use §§ 721(d)(1) or (d)(2) to now revoke their
3 discharge.
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5 The court understands that this is a frustrating result for the Trustee, who spent
6 time writing letters and filing pleadings (including the pleadings the court directed her to
7 file) in an effort to make the Debtors comply with their statutory obligations. The court
8 shares the Trustee's frustration, but the rules require that adversary proceedings be
9 filed to deny or revoke a discharge. Furthermore, to revoke a discharge, a debtor's
10 conduct must fall within the provisions of § 727(d). Absent such evidence, the
11 discharge cannot be revoked.
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13 One way to prevent the outcome in this case would be for the Trustee to obtain a
14 court order requiring the filing of returns, followed by the timely filing of an adversary
15 proceeding to deny the Debtors a discharge under § 727(a)(6). Because of the time it
16 may take for Debtors to file returns and the workload of trustees, it may be necessary to
17 extend the bar date for the trustees to file discharge complaints where Debtors have
18 failed to file their tax returns. Such motions will be freely granted by the court.
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20 In the alternative, the Trustee could notify the taxing authorities that the tax return has
21 not been filed. The taxing authorities may then request dismissal of the case under
22 § 521(j)(1).
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V. CONCLUSION

An Order to Show Cause may not be used to revoke a discharge. Even if the Trustee were to file an adversary proceeding in this case, she could not meet her burden of proof under § 727(d). Accordingly, the Debtors' discharge cannot be revoked.

DATED: March 14, 2008


HONORABLE EILEEN W. HOLLOWELL
UNITED STATES BANKRUPTCY JUDGE

COPIES mailed this 14th day of March, 2008, to:

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By /s/ Jannis Medina
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